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No. 453

STATE TAXATION ON INTERSTATE COMMERCE

REPORT

OF THE

SELECT COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ON

THE PROBLEMS FACED BY SMALL BUSINESS IN COMPLYING WITH MULTI-STATE TAXATION OF INCOME DERIVED FROM INTERSTATE COMMERCE

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JUNE 29, 1959.—Ordered to be printed

Mr. SPARKMAN, from the Select Committee on Small Business, submitted the following

REPORT

INTRODUCTION

During the 9 years it has been in existence, the Senate Small Business Committee has devoted a major share of its attention to the problems of small business in the field of taxation. Until this year, the committee has limited its attention to Federal tax laws and the administration of the Internal Revenue Code.

During 1952, your committee held a series of field hearings on taxes and, on June 18, 1953, issued its report on "Tax Problems of Small Business." [1] Four years later, in the fall of 1957, it conducted 14 hearings throughout the country. Forming the basis for small-business tax adjustments enacted later in the year, your committee's report was submitted to the Senate on January 30, 1958.[2]

On February 24, 1959, however, the Supreme Court issued its opinion on two cases, decided together, which in the words of Mr. Justice Clark, writing for the majority, concerned

> * * * the constitutionality of State net income taxes levying taxes on that portion of a foreign corporation's net income earned from and fairly apportioned to business activities within the taxing State when those activities are exclusively in furtherance of interstate commerce.[3]

By a 6 to 3 margin, the Court upheld the constitutionality of such State taxes.

A week later, the Supreme Court again ruled on this question and upheld the right of North Carolina to levy a tax directly on the net income of an interstate trucking firm.[4] Thus, the Court brought instrumentalities of interstate transportation under the same rule as manufacturers and sellers.

[1] S. Rept. 442, Senate Small Business Committee, 83d Cong., 1st sess.
[2] S. Rept. 1237, Senate Small Business Committee, 85th Cong., 2d sess.
[3] *Northwestern States Portland Cement Company* v. *State of Minnesota; T. V. Williams, as State Tax Commissioner* v. *Stockham Valves and Fittings, Inc.*, 358 U.S. — (1959), 79 Sup. Ct. 357 (1959).
[4] *E. T. and W. M. C. Transportation Co.* v. *James M. Currie*, 358 U.S. — (1959), 79 Sup. Ct. 602 (1959).

As soon as these decisions were announced, small businessmen doing business across State lines became concerned with the possible implications, and many of them contacted their Senators. The small-business ramifications of the problem clearly brought it within the purview of the committee and a public hearing was held by the full committee in Washington on April 8, 1959. A second hearing was held in Boston on May 1, at which time an additional 20 witnesses were heard. Further hearings were scheduled for New York City and Newark, N.J., on June 19, but these were canceled as a result of an important Senate vote. Witnesses scheduled to testify in those two cities submitted written statements to your committee for its study.[5]

This is not a new problem for the American businessman-taxpayer. Even the majority opinion in the February 24 cases stated that "this Court alone has handed down some 300 full-dress opinions [on State taxation and the commerce clause]." [6] The issue has been before the Supreme Court at least since 1824.[7]

While the Senate has given your committee the responsibility for studying the problems of small business, it believes that this investigation and the recommendations which follow have significance for all businesses, large and small, which face the problems of complying with various State and municipal taxes on income derived from interstate commerce. As will be pointed out later, however, this situation is particularly burdensome to small business.

SECTION I. IMPACT ON SMALL BUSINESS

Although there is still controversy over the question of whether the Northwestern States decision enlarged the authority of the States to tax out-of-State businesses on income derived from interstate commerce, there is no question that it has focused increased attention of businessmen and State taxing authorities on this power and has created a possibility of additional taxation in this field.

The small businessmen who communicated with this committee pointed out two major problem areas. First of all, they did not find a full answer in the Supreme Court decision to the question of the limit of a State's power to tax. It did not provide guide lines to the amount or kind of business activity which constituted a "sufficient nexus" to bring a company under the taxing jurisdiction of a State.

Secondly, these men testified to the tremendous difficulty they faced in complying with the more than 40 different State and local tax laws which were dissimilar in so many important respects. It was shown that it was possible for some firms to be taxed more than once on the same income and, at the same time, for other businesses to escape such taxes in large measure.

Therefore, stripped to its bare essentials, the problems presented to your committee consist of the difficulty of knowing what constitutes "doing business" from a legal point of view, the lack of uniform State laws and formulas for apportioning income to the various taxing jurisdictions, and the burdens of complying with the multiplicity of State and municipal laws and regulations.

[5] See hearings, "State Taxation on Interstate Commerce," Senate Small Business Committee, pt. I, Apr. 8, 1959; pt. II, May 1, 1959; pt. III, June 19, 1959. Hereafter noted as "hearings, pt. I", "hearings, pt. II", and "hearings, pt. III."

[6] Op cit.

[7] *Gibbon* v. *Ogden*, 22 U.S. 1 (1824).

At the time of your committee's hearings, 35 States, the District of Columbia, and at least eight cities taxed business income, including earnings derived from interstate commerce where there was local business activity. In addition, of course, there are other types of taxes to which these companies may be subjected, such as sales and use, gross receipts, property, and franchise.

For the intrastate business, there is no real difficulty in determining the amount of the State tax due, since it is all attributable to business conducted within one State. On the other hand, those doing business across State lines find it more difficult to determine what taxes they may be expected to pay in the several States in which they do business.

Most of the State business income taxes provide a formula for apportioning the amount of income attributable to that State. Unfortunately, however, no two States have exactly the same formulas. Therefore, the business taxpayer is hard pressed to comply with the rules and regulations of the various State taxing authorities.

In this report, your committee will not endeavor to deal with the technical questions of methods for apportioning income. The formulas currently in use are complex; even within the formulas, the meanings of basic words are inexact. For example, almost every one of the 35 income tax States uses a different definition to cover the term "sale." A "sale" may be considered to have taken place, according to these definitions, in any of these locations: in the place where the buyer and the seller met, where the goods were manufactured, where the goods were stored, where the transaction was finally approved, where the selling company was domiciled, where the salesmen's office was located, or where the goods were to be shipped. Indeed, for tax purposes, there may be other possible locations of the point of sale.

The nature of the problem before your committee varies in another manner. Large interstate corporations are generally licensed to do business in almost all States and have some form of plant, office, or business establishment in each of the States. By and large, it appears that these companies have been paying the various State taxes on income, even before the Supreme Court decisions of early 1959. On the other hand, the problem assumes a different complexion when a small business, conducting what is primarily a local enterprise, occasionally makes a sale or renders a service in another State. Is it liable to taxation in the other State? And, if it is, on what basis will the State determine its assessment?

In this section, your committee will outline the problems facing small businesses as a result of their potential liability for taxes on income derived from interstate commerce.

Your committee notes that, prior to the recent Supreme Court decisions, there were situations where local small-business firms were forced to compete against interstate businesses, sheltered against the assessment of the taxes which were being paid by the local businesses. Certainly in this case, there was no question of discrimination against interstate commerce. Indeed, the reverse prevailed.

On the other hand, too much stress should not be laid on the beneficence of the change brought about by these decisions, so far as small business is concerned. It is apparent that tremendously serious problems arise when every business firm is held liable for complying with a myriad of different tax levies in almost every State and in many cities in which it makes a sale or to which it ships a product.

As extreme cases, witnesses representing the mail-order industry appeared before your committee and asked if it was felt they could be taxed in every State to which they mailed an order. Similarly, radio and television stations have asked whether they could be taxed by every State and city in which their sales messages could be received.

The committee received much direct testimony about the difficulties of compliance, difficulties which arise from legal and accounting considerations.

In the first place, according to witnesses, few of the small businesses crossing State lines retain legal counsel in each of the States in which they operate. Furthermore, the varying regulations of the States and of the cities taxing business income snowball into such proportions that no one tax counsel can possibly advise his clients on all such tax problems.

Of perhaps even greater importance in assessing the burdens of compliance is the nature of the accounting system required to meet the varying State assessments. Since no two States are alike in their business tax codes, the magnitude of the task is obvious. An officer of one of the Nation's largest business corporations testified that his firm spent $170,000 annually merely to comply with the requirements of the States in which it did business.[8] The same witness also stated that he felt the proportionate cost of compliance would be much higher to small businesses, since the accounting and reporting task differed little whether the tax assessed was large or small. In addition, it is apparent that few of the small companies would have the battery of automatic business machines available to a giant corporation.

To cite specific instances: Many small-business firms that are fearful recent Supreme Court rulings render them liable for State taxation, do no more than send salesmen periodically into neighboring States. They have no property nor employees permanently residing in any State other than the one in which they are domiciled. Furthermore, these salesmen often cover more than one State. In such a case, the firm maintains no records on a State-by-State basis and would be forced to segregate hundreds or thousands of invoices to determine the amount of sales which might be allocated to each of the States.

Obviously, the costs of complying with such laws would be prohibitive. Therefore, it appears to your committee that the present situation may encourage many smaller firms to evade taxation in the hope that their activities are so minute and so sporadic that they will avoid detection. Any widespread evasion of this sort will certainly break down the morale of the American tax system, which is so largely based upon self-assessment.

In addition to the costs imposed upon the taxpayer are costs placed upon the tax collector. Testimony was received by your committee from commissioners of revenue and other tax administrators who pointed out that it would cost the collectors more to gather these small tax payments than the amount of the tax itself. While it might be assumed that stringent collection efforts would not be made in such cases, the tax system loses its fairness when a large number of citizens can avoid taxation in this way.

Further indirect costs of compliance arise when it is realized that, in many cases, what one State gains, another State loses by the very

[8] Hearings, pt. I, p. 55.

nature of the apportionment system. To cap it off, all costs of compliance are legitimate business expenses and can be deducted from the income which can be taxed by the Federal Government. Thus, it may cost business A $100 to pay a $25 tax bill to State B, but the $25 will be deducted from its home State's tax take, and the Federal Government may assume as much as $52 of A's costs. Certainly, large amounts of economic waste are involved in such a mutually defeating situation.

In the above example, the tax levied by State B was deducted from the tax which could be collected by the State of domicile of business A. Unfortunately, it is not always possible to offset such assessments, largely because of the differences in apportionment formulas. Thus, two States may both tax the same sale legally under their own laws if one taxes the sale at the point of negotiation of the sale and the other at the point of destination of the goods. For some firms, then, there is a well-founded fear that they will be taxed on more than 100 percent of their income by various States. Profs. Paul Studenski and Gerald J. Glasser, in a recent article, gave concrete examples of firms assessed on more than 100 percent of their income.[9]

Several other potential dangers to the small businessmen arising from State taxation of interstate commerce were delineated in your committee's hearings. One of them follows directly from the murky compliance paths pictured above.

There is the danger of retroactive assessments of taxes covering many years past. In the Supreme Court's Northwestern Portland Cement case, the Iowa firm was held liable for taxes dating back to 1933, when the Minnesota income tax law was passed. In this instance, the company was required to pay back taxes, penalties, and interest amounting to some $102,000. One witness told the committee that it was likely that every careful auditor examining the books of a company doing any interstate business would be forced to enter a caveat, warning balance-sheet readers that the firm might be subject to the payment of an undetermined amount of State taxes.[10] It is obvious that any such reservation would raise serious doubts in the minds of creditors and present or potential financial backers.

Even since the recent Supreme Court decisions, there is much doubt concerning the amount of business activity required to render a business liable for taxation in other States.

This section has dealt with the impact of multistate business taxation upon smaller businesses. In his dissenting opinion in the Northwestern States Portland Cement and Stockham Valves cases, Mr. Justice Frankfurter expressed his fears on the ramifications of the majority opinion in this manner:

> I think that interstate commerce will be not merely argumentatively but actively burdened for two reasons:
>
> First: It will not, I believe, be gainsaid that there are thousands of relatively small or moderate size corporations doing exclusively interstate business spread over several States. To subject these corporations to a separate income tax in each of these States means that they will have to keep books, make returns, store records, and engage legal counsel,

[9] Studenski and Glasser, "New Threat in State Business Taxation," 36 Harvard Business Review 77, November-December 1958.
[10] Hearings, pt. I, p. 46.

> all to meet the divers and variegated tax laws of 49 States, with their different times for filing returns, different tax structures, different modes for determining "net income," and different, often conflicting, formulas of apportionment. This will involve large increases in bookkeeping, accounting, and legal paraphernalia to meet these new demands. The cost of such a farflung scheme for complying with the taxing requirements of the different States may well exceed the burden of the taxes themselves, especially in the case of small companies doing a small volume of business in several States.

Your committee can fairly conclude, it would seem, that there is a real possibility that many smaller firms will remove themselves from interstate commerce so long as the present uncertainties and costly burdens remain. This would, in itself, be an unfortunate development. In addition, local businesses may well be deprived of important sources of goods if their smaller, independent suppliers cease interstate operations. Thus, the real or fancied impact of State business taxation can have serious repercussions down to the smallest store in the smallest community, or to the remotest individual dependent upon mail-order houses.

SECTION II. CONGRESSIONAL POWER TO ACT ON TAXATION OF INTERSTATE INCOME

Your committee is convinced that a serious problem now faces small businesses whose activities in any way cross State lines. From the hundreds of letters already received from these businessmen, it is apparent that they are aware of the nature of the problem and urgently desire some relief. Since that is the case, the committee must explore the extent of the power of Congress to take action in this field.

During its hearings, your committee heard several witnesses discuss congressional power under the commerce clause. In addition, it studied the words of the majority opinion and of the dissents in the Northwestern States Portland Cement and Stockham Valves cases.

Speaking for a majority of the Court, Mr. Justice Clark said:

> Commerce between the States having grown up like Topsy, the Congress meanwhile not having undertaken to regulate taxation of it, and the States having understandably persisted in their efforts to get some return for the substantial benefits they have afforded it, there is little wonder that there has been no end of cases testing out State tax levies * * *. It has long been established doctrine that the commerce clause gives exclusive power to the Congress to regulate interstate commerce, and its failure to act on the subject in the field of taxation nevertheless requires that interstate commerce shall be free from any direct restrictions or impositions by the States.

Mr. Justice Whittaker, writing the dissenting opinion in the same case, attributed an even greater, exclusive authority to the Congress in this field when he stated that—

> The commerce clause denies State power to regulate interstate commerce. It vests that power exclusively in Congress.

> Direct taxation of "exclusively interstate commerce" is a substantial regulation of it and, therefore, in the absence of congressional consent, the States may not directly tax it.

In numerous earlier decisions, the Supreme Court had also stated in explicit terms that the Congress retained the power to regulate interstate commerce and to tax such commerce. This has been true whether the Court in the instant case was permitting the States to act in the absence of congressional action or whether it disallowed State taxes on the grounds of the exclusiveness of congressional power.

Jerome Hellerstein, professor of law at New York University, testified before your committee on this constitutional question. Professor Hellerstein pointed to the Shreveport case [11] where the Supreme Court upheld the right of the Congress to regulate intrastate freight rates because of their impact on through interstate rates. He concluded that:

> * * * there would be no serious question among constitutional lawyers that Congress could impose restrictions on the extent to which States could tax interstate businesses unless they comply with uniform or particularly prescribed allocation methods. [12]

Many excellent law review articles have been written in recent years concerning State taxation of interstate commerce. An article by Mr. Hellerstein appears as appendix III to part I of the transcript of your committee's hearings on this subject. The article affirmed the power of Congress to limit taxation of interstate income by the States.[13]

All observers cited as a basic authority the opinion of Chief Justice Stone in the Southern Pacific case. The pertinent part of that opinion, with citations omitted, reads as follows:

> Congress has undoubted power to redefine the distribution of power over interstate commerce. It may either permit the States to regulate the commerce in a manner which would otherwise not be permissible, * * * or exclude State regulation even of matters of peculiarly local concern which nevertheless affect interstate commerce.[14]

At the request of your committee, the staff of the Library of Congress prepared a memorandum which included a section on the power of Congress to limit State taxation of interstate commerce. The memorandum, which appears as appendix IV to part I of the hearing record, expressed unequivocal agreement with those who have said that Congress can limit the States in their taxation of income from interstate commerce.[15]

Perhaps most persuasive of all the tests of the extent of congressional power is the citation of laws, now on the books, which have set the ground rules for State regulation and taxation of interstate commerce, with the assent of Congress.

As long ago as 1789, Congress extended the scope of State power by placing pilots of boats in interstate commerce under the States,

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[11] *Houston and T. Ry.* v. *U.S.*, 234 U.S. 342 (1914).
[12] Hearings, pt I, pp. 77-78.
[13] Ibid., pp. 135-163.
[14] *Southern Pacific Company* v. *Arizona*, 325 U.S. 761 (1945).
[15] Hearings, pt. I, pp. 164-166.

and this action was upheld by the Supreme Court.[16] More recently, the Court held, in 1944, that the States could not regulate insurance companies since they were in interstate commerce.[17] The following year Congress passed the McCarran Act,[18] allowing the States to regulate life insurance companies, and the congressional action was upheld in 1946 in the Prudential case.[19]

If one were to feel that the proper action for Congress to take in multistate taxation of income derived from interstate commerce was a statute prohibiting the States from levying such taxes unless they followed a fixed standard, he would find a close parallel in the imposition and collection of unemployment taxes by the States. In 1939, Congress passed an unemployment compensation act which allowed the States to levy taxes on business, whether local or interstate, so long as the State laws followed standards established by the Federal Government.[20]

Almost without exception, the witnesses appearing before your committee stated that Congress possessed extraordinary power in the field of interstate commerce, power which could be utilized in an almost unlimited manner.

Therefore, your committee concludes that there is no serious question about the ability of Congress to act in the area of State taxation of income derived from interstate commerce and that a constitutional amendment is not required, as some observers have suggested.

SECTION III. WHAT SHOULD BE DONE?

In the preceding sections of this report, your committee has endeavored to present the seriousness of the situation facing small-business firms doing business across State lines and has concluded that it is within the power of Congress to enact remedial legislation. The question now is: What should be done by Congress?

It appears that there are at least seven alternative courses for Congress to follow. In the following pages, the committee will explore the various possibilities and, in the next section, states its recommendations.

A. Do nothing, assuming the courts will formulate sound public policy

As it has largely done during the past 40 years, the Congress could avoid taking action in this field and hope that solutions might be found through judicial decisions.

During these decades, shifting judicial opinions have been the only guidelines to the boundaries of Federal-State power in the field of State taxation of interstate commerce. It is not the function of the judicial process to set public policy. Courts can act only on specific cases and decide issues argued in lower courts, thus seldom establishing general standards. While the Northwestern States Portland Cement case is quite clear, as much from the sharpness of the dissent as from the opinion of the majority, it states its conclusion in these words:

> We conclude that net income from the interstate operations of a foreign corporation may be subjected to state taxa-

[16] *Cooley* v. *Board of Wardens*, 53 U.S. (Howard) 298 (1851).
[17] *U.S.* v. *South-Eastern Underwriters Assn.*, 322 U.S. 533 (1944).
[18] 59 Stat. 34 (1945).
[19] *Prudential Insurance Company* v. *Benjamin*, 328 U.S. 408.
[20] 53 Stat. 581 (1939).

> tion provided the levy is not *discriminatory* and is *properly apportioned* to local activities within the taxing State forming *sufficient nexus* to support the same. [Italic supplied.]

As a practical matter, firms engaged in interstate commerce will find it difficult to decide with certainty whether or not they are subject to a State's taxes under the quoted language of the opinion, which is, after all, limited to the facts of the cases before the Court.

One witness gave a concise summary of the shortcomings of judicial action in his testimony. Prof. Harold M. Groves said:

> Thus far, protection of business and of fairness to the States has been left largely to the U.S. Supreme Court. This policy has several inherent weaknesses which the Court itself has been the first to recognize:
>
> 1. The Court's function is essentially negative. It confines its attention to what the States should be forbidden to do as beyond a reasonable exercise of their own discretion. It does not and cannot attempt to lead the States into common action which will, in the long run, best serve our overall economy. The Court has generally shown an increasing reluctance to thwart the States in meeting their revenue problems. It could be right in this and at the same time some of the States could be wrong (from the overall view) in overextending their jurisdiction.
>
> 2. The Court deals with specific issues as they arise; this has its advantages in many areas but it is not calculated to produce a comprehensive code.
>
> 3. The specific points as they arise are dealt with by a Court which is changing in personnel; this accounts for some of the inconsistencies and undependability of the code.[21]

Your committee rejects this negative approach. It feels that no prompt and workable solution will come through a series of prolonged court cases. The situation is serious; thousands of small businesses throughout the United States are affected, and the urgency of their pleas demands a logical proposal for assistance.

B. Forbid the States to tax income from interstate commerce

Your committee concludes that no such blanket prohibition should be imposed. A realistic look at the fiscal facts of life faced by the States confirms the impression that their revenue needs are tremendous and that all segments of their citizenry and their economy should bear a fair share of the costs of government. Since that is the case, there seems to be no logical reason for exempting from taxation those doing business in the State merely because they are domiciled elsewhere.

Thus, your committee feels that a State should have the right to tax the income of firms doing business in that State, if it decides to levy similar taxes on locally based businesses. Naturally, the caveat must be entered that any such taxation should be fairly apportioned and that sufficient nexus exists, so that no question of discrimination against interstate commerce may be raised.

[21] Hearings, pt. I, pp. 70–71.

C. Federal Government preempt taxation of income derived from interstate commerce with provision for allocation of the receipts among the States

Legislation might be enacted which would give the exclusive right to tax income arising from interstate business transactions to the Federal Government. Under such a law, the revenues thus collected would be allocated among the States. To eliminate friction in their Federal systems, Canada, Australia, and India have consolidated the taxing power in the hands of the Central Government, with a share of the receipts going to each of the political subdivisions.

While it is possible that this proposal might make such taxation simple and more efficient, your committee does not feel that this is an appropriate solution for the United States. Such a departure from present forms would do violence to the traditional balance of power between the Federal and State Governments. Furthermore, a very real, practical problem would exist in determining a proper allocation of tax receipts among the various States.

Therefore, your committee rejects this proposal as an unsound method for dealing with the problems treated in this report.

D. Recommend States to work together

In part, this fourth possible choice is a variant on the first one. It is more positive, however, in that it would express the sense of the Congress that the States should make a prompt and determined effort to work out the differences among them which now cause the greatest difficulties in multistate business taxation.

In several fields, the States have been able to cooperate to bring about a measure of uniformity among themselves. In highway-user taxes and in death taxes, progress has been made to bring order out of the former chaos of overlapping and duplicating State statutes.

On the other hand, the progress toward uniformity in State business taxation has been far less marked. As a matter of fact, little concrete evidence of achievement exists, even though the first attempts to bring about uniformity were made 40 years ago.

While your committee commends the continuation of efforts on the part of States and private groups to remedy the present situation, it reluctantly comes to the conclusion that other action should also be initiated. Without question, interstate negotiations are inevitably time consuming, even under the spur of recent court decisions. In addition, interstate compacts must also be approved by Congress if uniformity is to be achieved in that manner.

Your committee feels that the States must take an active role in any fair solution of the problem of multistate taxation of interstate commerce. Although it appears that State action is not sufficient, it must be an integral part of the overall approach to a successful outcome.

E. Pass uniform apportionment statute

During its research on these tax problems, your committee studied the various proposals which have been drafted to legislate a statute which would bring uniformity to State taxation of business income. The outstanding effort, to date, along this line was the proposal put forward by the National Conference of Commissioners on Uniform

State Laws.[22] Subcommittees of both the American Bar Association and the Council of State Governments approved the Commissioners' draft in 1957.

It should be noted, however, that other well-informed groups have seriously questioned certain features of the Commissioners' proposal. In addition, this draft deals only with the uniform division of income and does not treat certain fundamental issues which are basic to a full solution of the problem.

The States should also be given a greater opportunity to present their views and to cooperate in the final determination than would be possible through quick congressional action at this time. Since a great majority of the States currently depend heavily on business taxation for raising revenue, their attitudes and their experiences should carry significant weight.

Admittedly, however, the above draft and similar efforts by other bodies represent a sound approach. If it felt that sufficient information were now available, your committee would attempt to draft legislation immediately and press for action without delay. The information gathered in the hearings forces a conclusion, however, that there are many unknowns in the tax formula at this time. For example, there are no definitive data on the impact on the States of the various definitions of "sales." Preliminary conclusions were presented to the committee which indicated that more research along this line would produce a substantial body of facts which would lay at rest the fears of the States on the formula and the definitions finally agreed upon.

Thus, your committee points out the uniform statute as one of the essential keystones in the final solution of the multistate taxation problem, but concludes that it is not now in a position to draft a satisfactory formula.

F. Establish commission directed to report to Congress

The sixth possibility would be the establishment of a study commission to undertake the research necessary to formulate a sound and acceptable program for bringing about a rational and uniform system of State taxation of income earned in interstate commerce.

Such a commission should work closely with those groups which have already performed the fundamental groundwork. In addition, the commission should be directed to consult and cooperate with the States and bend every effort to gain the support of the States for its recommendations.

A possible disadvantage to this choice is the timelag which may be inherent in further study. However, in the long run, final congressional action may be expedited through the sound foundations laid by an expert study commission.

G. Pass law defining the act of "doing business"

Along with the problem of determining the proper apportionment of income among the various States in which it operates, the small- and medium-size business today faces its greatest difficulty in deciding whether it is legally "doing business" in some of these States, and therefore taxable. In both the Northwestern States Portland Cement and Stockham Valves cases, the out-of-State firm did have a fixed local place of business from which its salesmen regularly operated. The majority of the Supreme Court found this to be a sufficient nexus

[22] See draft, "Uniform Division of Income for Tax Purposes," hearings, pt. I, pp. 166-169.

to make it liable for State taxation on the portion of its income attributable to interstate commerce.

While deciding in favor of the States in these cases, however, the Court was not called upon to decide the ability of the States to tax firms without a fixed place of business. Throughout its hearings, your committee was impressed by the number of questions raised by many of the witnesses to which there is now no answer. Some of these queries revolved around the taxability of companies which merely sent salesmen into the State either on a regular or irregular schedule; others concerned mail-order businesses which shipped merchandise into the State on written orders. As a dramatic example of this situation, one witness stated that he now paid taxes on all his mail-order-business income in his State of domicile and that it would be all but impossible for him to apportion the income resulting from many thousands of orders ranging from a few cents to a few dollars to all the States.

In its only action directly touching upon this issue, the Congress has passed a business income tax for the District of Columbia which does limit liability to the tax to those firms which have a place of business within the District.

Your committee is of the opinion that much of the uncertainty now prevailing arises through the lack of a standard definition of "doing business." The tax administrators of the various States are also subject to the same doubts, since they cannot be certain that they have the authority to tax foreign businesses whose only local business activity consists of solicitation either by salesmen or by advertising.

The committee further believes that the Congress can set limits upon the power of the States to tax interstate commerce exclusively, and it feels the line should be drawn in accordance with the Supreme Court's Northwestern States decision.

Although there may be States which are now attempting to tax firms whose activities within the taxing jurisdiction are confined to solicitation of orders, your committee believes the number of such States is few and that the collection of income from such out-of-State businesses will be small and the costs of collection large. Certain it is that compliance on the part of small- and medium-size companies would be extremely costly.

SECTION IV. RECOMMENDATIONS

Your committee's recommendations are apparent from the preceding section. It urges the passage of a standard for testing the authority of the States to tax outside businesses, and it seeks the establishment of a commission to study all phases of the State taxation of interstate commerce problem.

Your committee has pointed out the serious defects in judicial action and the unlikelihood of achieving a sound and consistent solution through court cases.

The possibilities for remedying the present situation through cooperation among the States have also received much attention, both by witnesses who appeared before your committee and by other experts in the field. All these students of multi-state taxation were unanimous in their belief that such a process would be long drawn out and pointed out the lack of results in this area over the past 40 years.

On the other hand, there were several who felt that a combination of the sense of urgency engendered by the recent Supreme Court rulings and of strong congressional prodding would produce greater accomplishments during the coming months and years.

At this point, the question may be raised as to whether the full gamut of public interest would be well served by a course of action determined by the States alone. A State tax official, appearing before your committee, himself brought forward the fact that the States each had a strong self-interest in the adoption of some particular standards. Therefore, he concluded that—

> only Congress has the authority and power to prescribe and circumscribe the proper methods and bounds for taxing interstate income and to initiate and bring to fruition a fair and equitable apportionment of such income between the several taxing jurisdictions.[23]

After an appraisal of the possibility of achieving effective coordination among the States through judicial and State efforts, your committee finds the arguments for its recommendations even more persuasive.

The combination of a legal definition of "doing business" and a study group to propose solutions to other puzzles in the State taxation field should bring substantial relief to those small businesses that have petitioned your committee and the Congress for aid. At the same time, these proposals do not in any significant way limit the authority of the States or their ability to raise necessary revenues.

Your committee urges prompt consideration by the appropriate legislative committees of this problem and of these recommendations.

[23] Ibid., p. 37.

APPENDIX

86th Congress
1st Session

S.J. Res. —

IN THE SENATE OF THE UNITED STATES

Mr. Sparkman (for himself and Mr. Humphrey, Mr. Smathers, Mr. Morse, Mr. Bible, Mr. Randolph, Mr. Engle, Mr. Bartlett, Mr. Williams (N.J.), Mr. Moss, Mr. Saltonstall, Mr. Schoeppel, Mr. Javits, Mr. Cooper, Mr. Scott, and Mr. Prouty) introduced the following joint resolution; which was read twice and referred to the Committee on ----------

JOINT RESOLUTION

To bring about greater uniformity in State taxation of business income derived from interstate commerce; to establish a Commission on Taxation of Interstate Commerce; and for other purposes

Whereas the Constitution vests in the Congress the power to regulate interstate commerce, and

Whereas a free and unimpeded flow of commerce between the several States is vital to the economy and the general well-being of the Nation, and

Whereas the practice, presently engaged in by a number of the several States, of imposing a tax upon the income of businesses engaged in interstate commerce which operate or do business in such States has resulted in subjecting such businesses to a multiplicity of income tax laws which are independently imposed, lack uniformity in substance and application, and are often inconsistent in theory and administration, and

Whereas such practice has tended to impede, obstruct, restrain and embarrass the free flow of commerce between the several States, and

Whereas in order to insure the free and uninterrupted flow of commerce between the several States, it is imperative that the several States be permitted to impose income taxes upon businesses engaged in interstate commerce only in accordance with reasonable and uniform standards: Now therefore be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I—TEMPORARY MINIMUM STANDARD

SECTION 101. No State or political subdivision thereof shall impose a tax upon the income of any business engaged in interestate commerce for any taxable year unless, during such year, such business has maintained a stock of goods, an office, warehouse, or other place of business in such State or has had an officer, agent, or representative who has maintained an office or other place of business in such State.

SEC. 102. The provisions of section 101 shall apply only with respect to taxable years which end after December 31, 1958, and which begin before January 1, 1961.

TITLE II—COMMISSION ON STATE TAXATION OF INTERSTATE COMMERCE

DECLARATION OF PURPOSE

SEC. 201. It is the purpose of this title to provide for the formulation of a concrete proposal for an equitable solution to the problems experienced (1) by businesses (particularly small businesses) engaged in interstate commerce as the result of their being subjected to a multiplicity of income taxes independently imposed by the various States in which they operate or do business, and (2) by the various States in which such businesses operate or do business in assuring that such businesses shall be required to assume a fair share of the tax burden imposed upon the residents of, and businesses located within, such State.

ESTABLISHMENT OF COMMISSION

SEC. 202. (a) In order to carry out the purposes of this title, there is hereby established a Commission to be known as the "Commission on State Taxation of Interstate Commerce" (hereinafter referred to as the "Commission") which shall be composed of five members to be appointed by the President, by and with the advice and consent of the Senate. The members of the Commission shall be individuals from private life who are familiar with the problems connected with State taxation of income of businesses (particularly small businesses) engaged in interstate commerce and who, by reason of education, training, or experience, are peculiarly qualified to carry out the duties of the Commission.

(b) The Commission shall elect a Chairman from among its members.

(c) Any vacancy occurring in the Commission shall not affect its powers, but shall be filled in the same manner in which the original appointment was made.

(d) Three members of the Commission shall constitute a quorum, except that the Commission may establish a lesser number as a quorum for the purpose of taking sworn testimony.

(e) Members of the Commission shall be compensated at the rate of $20,000 per annum and shall be reimbursed for any travel, subsistence, or other necessary expenses incurred by them while engaged in the actual performance of the duties of the Commission.

(f) Service of an individual as a member of the Commission or employment of an individual by the Commission as an attorney or employee in any business or professional capacity, on a part-time or full-time basis, with or without compensation, shall not be considered as service or employment of such individual within the provisions of section 281, 283, 284, or 1914 of title 18 of the United States Code, or section 190 of the Revised Statutes (5 U.S.C. 99).

STAFF OF THE COMMISSION

SEC. 203. (a) The Commission shall have the authority to appoint, without regard to the civil service laws and the Classification Act of 1949, as amended, such personnel as it deems necessary to enable it to discharge its duties under this title.

(b) The Commission may procure, without regard to the civil service laws and the Classification Act of 1949, as amended, temporary and

intermittent services to the same extent as is authorized for the departments by section 15 of the Act of August 2, 1946 (60 Stat. 810), but at rates not to exceed $50 per diem for individuals.

DUTIES OF THE COMMISSION

SEC. 204. (a) The Commission shall conduct a thorough and complete study and investigation of all matters pertaining to the taxation by States of the income of businesses (particularly small businesses) engaged in interstate commerce for the purpose of enabling the Commission to formulate and recommend to the Congress a concrete proposal for legislation providing for the establishment of uniform standards which the States will be required to observe in imposing income taxes upon businesses engaged in interstate commerce. Such standards shall be designed to permit any State to require businesses engaged in interstate commerce which operate or do business in such State to assume a fair share of the tax burden of such State, but shall, at the same time, be designed to protect such businesses (particularly small businesses) from being unduly hampered or embarrassed in their operations by reason of being subjected to a multiplicity of income tax laws which are independently imposed by the various States in which such businesses operate or do business and which not only are not uniform either in substance or application but which are often inconsistent in theory and administration.

POWERS OF COMMISSION

SEC. 205. (a) In carrying out its duties under this title, the Commission, or any duly authorized committee thereof, is authorized to hold such hearings, sit and act at such times and places, take such testimony, and make such expenditures as the Commission or such committee may deem advisable. The Chairman of the Commission or any member authorized by him may administer oaths or affirmations to witnesses appearing before the Commission or before any committee thereof. The Commission shall have such power of subpena and compulsion of attendance of witnesses and production of documents as are conferred upon the Securities and Exchange Commission by subsection (c) of section 18 of the Act of August 26, 1935, and the provisions of subsection (d) of such section shall be applicable to all persons summoned by subpena or otherwise to attend and testify or produce such documents as are described therein before the Commission, except that no subpena shall be issued except under the signature of the Chairman, and application to any court for aid in enforcing such subpena may be made only by the Chairman. Subpenas shall be served by any person designated by the Chairman.

(b) The Commission is authorized to secure from any department, agency, or independent instrumentality of the Government such information or assistance as the Commission may deem necessary or desirable to enable it to carry out its duties under this title.

COOPERATION WITH STATES AND PRIVATE PERSONS

SEC. 206. In carrying out its duties, the Commission shall cooperate with States and with private persons or private organizations who are able to assist the Commission in carrying out the purposes of this

title. The Commission is further authorized to utilize the uncompensated services of private individuals or of State or local employees in carrying out its duties.

EXPENSES OF THE COMMISSION

SEC. 207. There is hereby authorized to be appropriated out of any money in the Treasury not otherwise appropriated, such amount, not in excess of $----------, as may be necessary to carry out the provisions of this title.

REPORT BY AND EXPIRATION OF COMMISSION

SEC. 208. (a) The Commission shall report to the Congress the results of its study and investigation along with its proposals for legislation on or before February 1, 1961.

(b) On July 31, 1961, all authority under this title shall terminate and the Commission shall cease to exist.

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